

Overview of 2006 Income Tax Law Changes

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IRS Tax Forms & Publications

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IRA Deduction

IRA deduction rules changed:

- ☐ Maximum deductible contribution increased to **\$5,000** for taxpayers **age 50 or older** at the end of the year. No change for other taxpayers.
- ☐ Modified AGI phase-out range increased to **\$75,000-\$85,000** for married taxpayers filing jointly and qualifying widow(er)s. No change for other taxpayers.
- ☐ Nontaxable combat pay treated as earned income for the deductible limit **after 2003**. Contributions for 2004 and 2005 can be made through May 28, 2009.



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Higher Limits for Employee Contributions to 401(k), 403(b), 457, and SIMPLE Plans

- ☐ Maximum increases to **\$15,000** (**\$10,000** for SIMPLE plans).
- ☐ Workers age 50 and older may contribute **\$5,000** more (**\$2,500** more for SIMPLE plans).
- ☐ More generous limits for participants in 457 plans who are within 3 years of retirement.

Qualified Roth Contribution Programs

- ☐ For tax years beginning after 2005, section 401(k) and 403(b) plans can create a qualified Roth contribution program to allow participants to elect to treat part or all of their elective deferrals as after-tax Roth contributions
- ☐ Plan must establish a separate account for designated Roth contributions and earnings
- ☐ Contributions are subject to elective deferral limits, but not any of the income limits that apply to Roth IRAs
- ☐ For a list of frequently asked questions regarding designated Roth accounts, visit www.irs.gov/retirement/article/0,,id=152956,00.html#4

Other Retirement Plan Provisions

- ☐ For distributions made after September 11, 2001, the 10% early withdrawal penalty does not apply to qualified reservist distributions. A qualified reservist distribution is one made by a reservist called to active duty for a period of at least 180 days from an IRA or from amounts attributable to elective deferrals under a 401(k) plan, 403(b) annuity, or certain similar arrangements. Amended returns for closed years may be filed through August 16, 2007. The amount withdrawn may be repaid to an IRA within 2 years after the later of August 17, 2006, or the day after the active duty period ends.
- ☐ For distributions made after August 17, 2006, from a governmental defined benefit pension plan, the 10% early withdrawal penalty does not apply to a qualified public safety employee who separates from service after age 50.
- ☐ For tax years beginning after 2005, IRA distributions (up to \$100,000) made directly by the trustee to a charity generally are excluded from income if the taxpayer is at least age 70-1/2.

Capital Asset Treatment for Self-Created Musical Works



A taxpayer may elect to treat a musical composition or musical copyright as a capital asset if:

- ☐ The taxpayer's personal efforts created the property (or the property has a basis determined by reference to the basis in the hands of the taxpayer whose personal efforts created the property), and
- ☐ The property was sold or exchanged in a tax year beginning after May 17, 2006. For calendar year taxpayers, this provision takes effect in 2007.

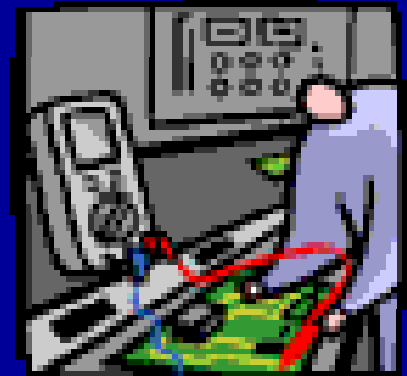
Amortization of Musical Compositions and Copyrights

- ☐ For tax years beginning after 2005, taxpayers can elect to amortize capital expenditures paid or incurred in creating or acquiring musical compositions (and copyrights of such compositions).
- ☐ The property must be amortized ratably over a 5-year period beginning with the month the property is placed in service.
- ☐ Election does not apply to amortizable section 197 intangibles, qualified creative expenses, or to property for which the simplified section 263A(i)(2) procedures apply.

Domestic Production Activities Deduction

For tax years beginning after
May 17, 2006:

- ❑ The limit equal to 50% of Form W-2 wages is no longer based on Form W-2 wages from all businesses. Only wages properly allocable to domestic production gross receipts are included.
- ❑ The rules for determining Form W-2 wages of partners and S corporation shareholders are simplified by determining wages solely at the entity level.



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Increase in Meal Expense Limit for Certain Transportation Workers

For 2006, workers who are subject to the Department of Transportation hours of service limits can deduct 75% of business meals consumed during, or incident to, any period of duty when those limits are in effect. This includes certain air transportation workers, interstate truck operators, interstate bus drivers, certain railroad workers, and certain merchant mariners.



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Phaseout of Reductions of Personal Exemptions and Itemized Deductions

For 2006, the amount by which these amounts can be reduced is only $\frac{2}{3}$ of the amount that would otherwise apply.

Example. The maximum reduction for the \$3,300 personal exemption for 2006 is \$2,200. The minimum exemption allowed after the phaseout is \$1,100.



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Charitable Contribution Provisions

- ❑ For tax years after 2005, the decrease in basis of S corporation stock from a charitable contribution of property is equal to the shareholder's pro rata share of the property's adjusted basis.
- ❑ For tax years after 2005, the AGI limit and carryover period is increased for qualified conservation contributions.
- ❑ For contributions made after July 25, 2006, new restrictions apply to certain contributions of real property located in a registered historic district. A \$500 filing fee may apply to certain deductions of over \$10,000 for contributions made after February 12, 2007.
- ❑ For contributions of taxidermy property made after July 25, 2006, the deduction is generally limited to the lesser of the taxpayer's basis or the fair market value of the property. New basis restrictions apply.
- ❑ For contributions made after August 17, 2006, no deduction is allowed for most contributions of clothing and household items unless the property is in good used condition or better.
- ❑ Cash contributions made in tax years beginning after August 17, 2006, must be supported by a dated bank record or receipt.

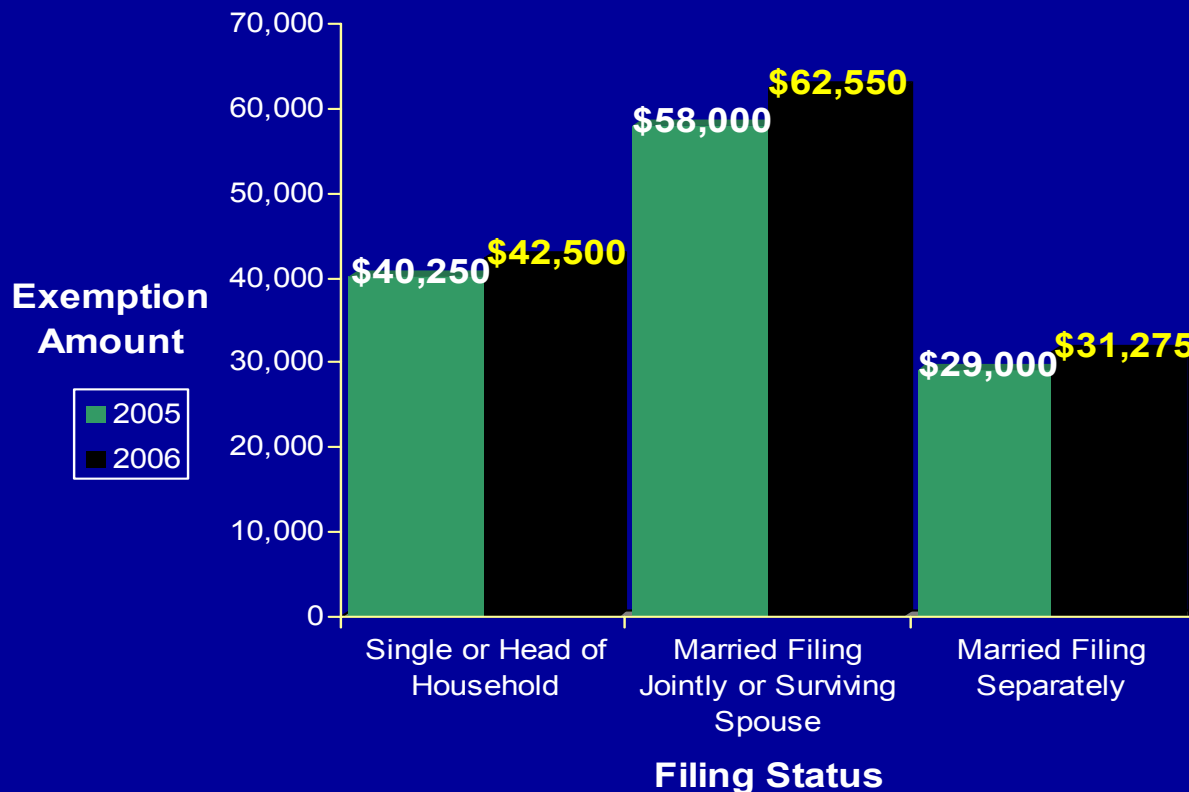
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Increase in Alternative Minimum Tax Exemption Amount

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Foreign Earned Income Exclusion & Foreign Housing Deduction

- ❑ For tax years beginning after 2005, the maximum foreign earned income exclusion is indexed to inflation. For 2006, the maximum exclusion is \$82,400.
- ❑ The foreign housing deduction is modified as follows.
 - The housing cost floor is 16% of the maximum foreign earned income exclusion.
 - Actual housing expenses generally are capped at 30% of the maximum foreign earned income exclusion.
- ❑ Non-excluded income is taxed for both the regular tax and the AMT at the marginal rates that would apply if taxable income included the foreign earned income exclusion and foreign housing exclusion.

Increase in Age for Children Taxed at Parent's Rate on Unearned Income

- ☐ For tax years beginning after 2005, IRC section 1(g) taxes the net unearned income of certain children who are **under age 18** at the end of the year at the parent's rate on Form 8615.
- ☐ This change also applies to the parent's election on Form 8814 to include on the parent's return certain unearned income of the child.
- ☐ IRC section 1(g) no longer applies to a child who is married and files a joint tax return for the year.
- ☐ Under the provision, income the child receives from a qualified disability trust is treated as earned income.

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Residential Energy Credits

For 2006, two new residential energy credits can be claimed on **Form 5695**:

☐ **Nonbusiness energy property credit.** Maximum credit of \$500. Must be new property and installed in or on main home. Total of:

1. 10% of qualified energy efficiency improvements: insulation, exterior windows and skylights (up to \$2,000), exterior doors, coated metal roofs that reduce heat gain, plus
2. 100% of cost of eligible (a) heat pumps, central air conditioners, and water heaters (up to \$300), (b) natural gas, propane, or oil furnaces; and hot water boilers (up to \$150), and (c) advanced main air circulating fans (up to \$50).

☐ **Residential energy efficient property credit.** Credit is up to 30% of qualified photovoltaic, solar water heating, and qualified fuel cell property costs. Additional limits apply.

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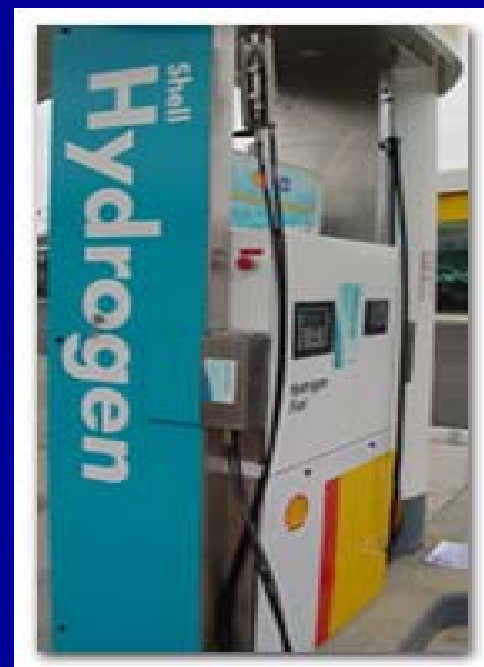
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Alternative Vehicle Credits

☐ **Alternative motor vehicle credit (Form 8910).** Includes fuel cell, advanced lean-burn, hybrid, and alternative fuel vehicles placed in service after 2005 (general business credit to extent of business portion and remainder is a personal credit).



☐ **Alternative fuel vehicle refueling property credit (Form 8911).** 30% of cost of property placed in service after 2005. Maximum credit is \$1,000 for each property (\$30,000 for each depreciable property) (general business credit to extent of business portion and remainder is a personal credit).



Bond Credits

Two new tax-credit bonds entitled the bond holder to a tax credit instead of interest. The credits are allowed against the regular tax and the AMT and are included in the bond holder's income. Form 8912 is used to claim the credit.

☐ **Clean renewable energy bond credit.** May be issued in 2006 or 2007 under an allocation made by the IRS to the issuer for a facility used to produce electricity using wind, closed-loop biomass, open-loop biomass, geothermal or solar energy, small irrigation power, landfill gas, municipal solid waste, refined coal, or qualified hydroelectric production.

☐ **Gulf bond credit.** May be issued during 2006 by the state of Louisiana, Mississippi, or Alabama. Maturity cannot exceed 2 years.

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Credit for Federal Telephone Excise Tax

- ☐ Telephone tax on long distance service no longer taxed after July 31, 2006. Includes bundled local and long distance service.
- ☐ Local service will continue to be taxed.
- ☐ Refund of tax paid can be claimed on a new line of 2006 income tax returns as a refundable credit.
- ☐ Form 8913 used to claim actual taxes paid for over the last 3 years. Individuals may claim a safe harbor amount instead of actual amount.
- ☐ Individuals not required to file an income tax return may claim refund on new Form 1040EZ-T.
- ☐ Interest will be paid on refunds.



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Information Reporting for Tax-Exempt Interest

OMB No. 1545-0112	
2006	Interest Income
Form 1099-INT	

Interest paid after 2005 on a tax-exempt state or local bond is subject to information reporting on Form 1099-INT.

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Split Refund Option

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- ☐ Refunds can be split among up to 3 deposit accounts.
- ☐ Form 8888 must be filed if refund is split.
- ☐ Applies to filers of Forms 1040, 1040A, 1040EZ, 1040NR, 1040NR-EZ, 1040-PR, and 1040-SS.

Form 8888 **Direct Deposit of Refund** OMB No. 1545-1473
 Department of the Treasury Internal Revenue Service **2006** Attachment Sequence No. 56
 ▶ See instructions below and on back. ▶ Attach to Form 1040, Form 1040A, Form 1040EZ, Form 1040NR, Form 1040NR-EZ, Form 1040-SS, or Form 1040-PR.

Name(s) shown on return _____ Your social security number _____

1a Amount to be deposited in first account **1a**
b Routing number ☐ Checking ☐ Savings
d Account number

2a Amount to be deposited in second account **2a**
b Routing number ☐ Checking ☐ Savings
d Account number

3a Amount to be deposited in third account **3a**
b Routing number ☐ Checking ☐ Savings
d Account number

4 Total amount to be directly deposited. Add lines 1a, 2a, and 3a. The total must equal the amount shown on Form 1040, line 73a, Form 1040A, line 45a, Form 1040EZ, line 11a, Form 1040NR, line 71a, Form 1040NR-EZ, line 23a, Form 1040-SS, line 12a, or Form 1040-PR, line 12a, **4**

General Instructions
Purpose of Form
 Use Form 8888 if you want us to directly deposit your tax refund into either two or three of your accounts at a bank or other financial institution (such as a mutual fund, brokerage firm, or credit union) instead of sending you a check. An account can be a checking, savings, or individual retirement arrangement (IRA) (see page 2 for more information on IRAs).
Note: If you want your refund deposited into only one account, do not complete this form. Instead, you can request a direct deposit of your refund on the tax return you are filing.
Why Use Direct Deposit?
 • You get your refund fast—even faster if you e-file!
 • Payment is more secure—there is no check to get lost.
 • More convenient. No trip to the bank to deposit your check.
 • Saves tax dollars. A refund by direct deposit costs less than a check.
TIP You can check with your financial institution to make sure your deposit will be accepted and to get the correct routing and account numbers. The IRS is not responsible for a lost refund if you enter the wrong account information.

Specific Instructions
 If you file a joint return and you complete and attach Form 8888, you are appointing your spouse as an agent to receive the refund. This appointment cannot be changed later.

CAUTION Some financial institutions will not allow a joint refund to be deposited into an individual account. If the direct deposit is rejected, a check will be sent instead. The IRS is not responsible if a financial institution rejects a direct deposit.

Lines 1a, 2a, and 3a
 Enter the portion of your refund you want directly deposited into each account. The amount of your refund can be found on Form 1040, line 73a, Form 1040A, line 45a, Form 1040EZ, line 11a, Form 1040NR, line 71a, Form 1040NR-EZ, line 23a, Form 1040-SS, line 12a, or Form 1040-PR, line 12a. The total of lines 1a, 2a, and 3a must equal the total amount of your refund.

Lines 1b, 2b, and 3b
 The routing number must be nine digits. The first two digits must be 01 through 12 or 21 through 32. Otherwise, the direct deposit will be rejected and a

Sample Check

FRANK MAPLE
BARBARA MAPLE
123 Pear Lane
Anyplace, VA 20000

PAY TO THE ORDER OF _____ \$ 1234

ANYPLACE BANK
Anyplace, VA 20000

For _____
1-2502500231-202020-86-1234

Note. The routing and account numbers may be in different places on your check.

For Paperwork Reduction Act Notice, see back. Cat. No. 21858A Form 8888 (2006)

Expired Individual Provisions

The following individual tax benefits expired in 2005:

- ☐ Deduction from AGI for educator expenses
- ☐ Tuition and fees deduction
- ☐ Deduction for clean-fuel vehicles
- ☐ Deduction for state and local general sales taxes
- ☐ Special rules for qualified contributions
- ☐ District of Columbia first-time homebuyer credit (for homes purchased after 2005)



Expired Business Provisions

The following business tax benefits have expired:

- ☐ Accelerated depreciation for qualified Indian reservation property placed in service after 2005
- ☐ Deduction for clean-fuel vehicle property and clean-fuel vehicle refueling property placed in service after 2005
- ☐ Work opportunity & welfare-to-work credits (for employees hired after 2005)
- ☐ Research credit (for amounts paid or incurred after 2005)
- ☐ Indian employment credit (for tax years beginning after 2005)
- ☐ 15-year recovery period for qualified leasehold improvements placed in service after 2005
- ☐ Credit for electricity produced from a facility using solar energy (for a facility placed in service after 2005)
- ☐ Tax incentives based on the District of Columbia Enterprise Zone (for any period after 2005)
- ☐ Possessions corporation tax credit (for tax years beginning after 2005)

New 2006 Income Tax Forms

- ☐ **Form 1040EZ-T**, *Claim for Refund of Federal Telephone Excise Tax*
- ☐ **Schedules M-3 for Forms 1065, 1120-L, Form 1120-PC, and 1120S** [*net income (loss) reconciliation for entities with total assets of \$10 million or more*]
- ☐ **Schedule O (Form 1120)**, *Consent Plan and Apportionment Schedule for a Controlled Group*
- ☐ **Form 5695**, *Residential Energy Credits*
- ☐ **Form 8888**, *Direct Deposit of Refund*
- ☐ **Form 8909**, *Energy Efficient Appliance Credit*
- ☐ **Form 8913**, *Credit for Federal Telephone Excise Tax Paid*
- ☐ **Form 8916**, *Reconciliation of Schedule M-3 Taxable Income with Tax Return Taxable Income for Mixed Groups*
- ☐ **Form 8916-A**, *Reconciliation of Cost of Goods Sold Reported on Schedule M-3*

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Pending Legislation

H.R. 5970, Estate Tax and Extension of Tax Relief Act of 2006

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Additional Resources

☐ **Draft 2006 forms:**

www.irs.gov/taxpros/lists/0,,id=97784,00.html

☐ **Final forms:**

www.irs.gov/formspubs/lists/0,,id=97817,00.html

☐ **Pub. 553:** www.irs.gov/pub/irs-pdf/p553.pdf

☐ **Legislation:** <http://thomas.loc.gov>

☐ **E-mail:** *taxforms@irs.gov



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